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Dear Sir
Exposure Draft ED 142
Financial Reporting of General Government Sectors by Governments

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and submit the following response to the exposure draft referred to above.

This letter brings together the views of seven of the nine Australian members of ACAG, the exceptions being for the Auditor-General for South Australia, who reserves his right to respond separately to auditing and accounting Exposure Drafts where he deems it appropriate, rather than as a member of ACAG, and the Auditor-General of Victoria who has already made a separate submission. Therefore, any reference to ACAG members, or to "we", in this letter is to these seven Australian members.
ACAG members commend the work done by the Board to bring together in one financial report the reporting requirements of Generally Accepted Accounting principles (GAAP) and Government Finance Statistics (GFS).

The key aspects of this response are as follows.

1. While disappointed that full convergence has not been achieved, we believe that the financial reporting proposed by ED 142 will be an improvement on current reporting whereby budget outcome numbers reported under GFS, as well as their relationship to GAAP, remain unaudited in a number of jurisdictions.

2. We can accept the merit in accepting the GGS is a reporting entity whose financial reports will be general purpose because there exist users who cannot command specifically the information to be included in the financial reports of the GGS; and

that partial consolidation is necessary for reporting on GGS, but only on the basis, as proposed, that there continue to be Whole of Government financial reports presented on a full consolidation basis and that the relationship between the two financial reports be fully disclosed.

3. We support the stated objective of the Financial Reporting Council's strategic direction that outcome statements be directly comparable with the relevant budget statements. While budget numbers may be revised more than once during a financial year, the minimum relevant comparison required should be against the original budget, as proposed.

4. We also note the relevance of the proposal to include explanations of budget variances as mandatory disclosures in the financial statements. Explanations of revisions to original budget numbers would be given as revisions are published during the year. In addition, we envisaged practical difficulties for both the presentation and auditing of the explanations. We suggest that the inclusion of explanations of variations be encouraged but not mandated and that the matter be considered further in the context of the International Public Sector Accounting Standards Board's work on Budget Reporting. However, in the event that the AASB decides to include reporting against budget outcomes in the standard, we believe that it should be a requirement that explanation for variations be audited.

5. We do not favour the columnar presentation proposed in the guidance due the presentation difficulties it has. A down the page approach is more practical.

6. We encourage early progress with the rest of Phase 1 of the convergence process in order in particular to minimise the potential for accounting policy and presentation differences between GGS reports and the reporting of GGS within Whole of Government Reports.

The opportunity to raise comment is appreciated and I trust you will find the attached comments useful. Thank you or providing us with additional time in which to make this submission.

Yours sincerely

Mike Blake
Chairperson
ACAG Financial Reporting Group

23 December 2005

ATTACHMENT

SUBMISSION BY THE AUSTRALIAN MEMBERS (EXCEPT FOR THE AUDITORS-GENERAL FOR SOUTH AUSTRALIA AND VICTORIA) OF THE AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL ON ACCOUNTING EXPOSURE DRAFT -

ED 142: Financial Reporting of General Government Sectors by Government

(a) the proposal in paragraph 5 that the GGS (as defined in GFSM 2001) of a government is a reporting entity;

We can accept the merit in accepting the GGS, as defined in GFSM2001, is a reporting entity because it is "reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources".

We acknowledge that there may be disagreement within the profession over this proposal and recommend that the AASB should seek to finalise the remaining parts of Phase 1 of the Harmonisation Project as expeditiously as possible. We would see this place the GGS report explicitly within the harmonised Whole of Government general purpose financial report.

(b) **the proposal, implicit in paragraph 5, that a GGS financial report prepared on a partial consolidation basis is a GPFR together with the proposal in paragraph 18 that the GGS should be prohibited from consolidating controlled entities in the PNFC sector and the PFC sector;**

We agree that the GGS financial report prepared on a partial consolidation basis is a GPFR together with the proposal in paragraph 18 that the GGS should be prohibited from consolidating controlled entities in the PNFC sector and the PFC sector.

The proposed standard will identify a clear framework for preparing the financial report on the GGS, even though it may not comply with all aspects of other accounting standards.

(c) the proposal in paragraphs 8 to 12 that, with limited significant exceptions, the GGS financial report should comply with other Australian Accounting Standards and, where it does not conflict with Australian Accounting Standards, GFSM 2001. The Board is particularly interested in comments on the proposal that where Australian Accounting Standards allow for optional treatments, only those treatments aligned with GFSM 2001 should be applied for the purposes of GGS financial reporting;

It is important that the GGS financial report should comply with other Australian Accounting Standards, subject to the limited significant exceptions identified.

Differences between GAAP and GFS frameworks should be kept to a minimum and be permitted only where there is an irreconcilable difference between the two, so as not to defeat the purpose of harmonisation. Accordingly, we believe that it is essential to mandate the accounting treatments that align with GFSM 2001 where the accounting standards allow for optional treatments. This will also improve comparability between jurisdictions, as required by the FRC's strategic direction.

However, selection of an optional treatment on the basis it is aligned with GFSM requirements may present practical difficulties in certain circumstances. For example Para 11 (b) and (c) require use of fair value for assets that fall within the scope of AASB 116, AASB 138, AASB 139 and AASB 140. In some cases it would be impracticable to determine "fair values" for these assets within GGS entities, eg most internally developed intangibles held by government agencies are unlikely to have an available market from which fair value can be determined. Likewise in Queensland, the Treasury Department elected to allow use of cost for certain classes of non-current physical assets on the basis that it is not cost effective to obtain valuations for assets in these classes. Accordingly, subject to materiality considerations, it may not be practicable or cost effective to require entities within the GGS to have assets valued for the purpose of this standard, where they would otherwise be recorded at cost.

(d) the proposal in paragraphs 13 to 17 to require or allow disclosure of information in the GGS financial report that is determined in accordance with GFSM 2001 and, where it is determined in a different manner from corresponding information prepared in accordance with Australian Accounting Standards, provide a reconciliation to the GFS-related information;

We are disappointed that full convergence has not been achieved and that the proposed financial report for the GGS has to proceed on a reconciliation basis. As a result there is a need to minimise the possibility of confusion arising in understanding the financial affairs of a government.

Nevertheless, it is important that the report, which would be audited, reflect the needs of both GAAP and GFS users, and the corresponding information be reconciled.

(e) the proposals in paragraphs 19 to 23 that:

- **(i)** **the GGS's equity investment in non-consolidated controlled entities should be measured at fair value where fair value is reliably measurable and at the government's proportional interest in the net assets of the controlled entities where fair value is not reliably measurable;**
- **(ii)** **where net assets is used as the basis of measurement, it is determined in a manner consistent with the net assets that are consolidated into the whole of government GPFR;**
- **(iii)** **changes in the carrying amount of the GGS's equity investment in non-consolidated controlled entities during a reporting period are treated in**

a manner consistent with the treatment of a change in fair value under AASB 139 even if the carrying amount is not fair value; and

(iv) specify the treatment of jointly controlled entities and associates;

(i) We support in principle, the requirement to measure the GGS's equity investment in non-consolidated controlled entities at fair value in accordance with AASB 139 where fair value can be reliably measured; and at the government's proportional interest in the net assets of the controlled entities where fair value cannot be reliably measured. Consideration should be given to limiting the reliable fair values to values obtained in an active market - while it may be possible to value an entity by appraisal, there may not be much practical benefit unless privatisation or sale is contemplated.

(ii) We support the proposal that where net assets is used as the basis of measurement, it be determined in a manner consistent with the net assets that are consolidated into the whole of government GPFR. This concept is consistent with the principles of the consolidation standard which requires uniform accounting policies to be used for like transactions and other events in similar circumstances in the preparation of consolidated financial statements.

However, the standard needs to clarify whether the proposal intends that related balances with GGS entities be eliminated before determining the net assets, as they would be in preparing the Whole of Government reports.

(iii) We acknowledge the practical difficulties of having to fair value all the assets in the other sectors of government and therefore determining the fair vale of such "investments" is often not possible. In the absence of readily available information regarding the fair value of non-consolidated controlled entities, we support the proposal to require the changes in the carrying amount of the GGS's equity investment in non-consolidated controlled entities during a reporting period to be treated in a manner consistent with the treatment of a change in fair value under AASB 139 even if the carrying amount is not fair value. However, ACAG members believe that these non-consolidated controlled entities should be encouraged to measure their assets and liabilities at fair value.

(iv) We support the proposal in paragraph 23 because it minimises the differences between this report and the Whole of Government treatment of these entities.

(f) the proposals in paragraphs 26 to 31 relating to the format and content of the balance sheet and the treatment of convergence differences;

There is a presumption in paragraph 29 in favour of a liquidity basis of presentation over the current/non-current distinction in the Exposure Draft, which may not be justifiable in all cases. There appears to be a difference of approach currently between jurisdictions in their GAAP reports.

Paragraphs 53 and 54 of AASB 101 provide guidance on this issue. In some government contexts, activities are mainly in the areas of provision of goods and services within a clearly identifiable operating cycle. Accordingly, in those circumstances, the separate classification of current and non-current assets and liabilities on the face of the balance sheet will provide more useful information by distinguishing the net assets that are continuously circulating as working capital from those used in long-term operations. Accordingly, mandating the liquidity basis may not, in all cases, present more reliable and relevant information to users.

We support the proposal for the requirement to identify, and disclose explanations of, convergence differences between GAAP and GFS.

The proposed minimum GFSM2001 disclosure (of net worth) should appear on the face of the balance sheet, reflecting the fact that full convergence has not been achieved; other differences and explanations should be in the notes, to allow the face of the statements to cope with comparatives and budget numbers.

(g) the proposals in paragraphs 32 to 40 relating to the format and content of the operating statement and the treatment of convergence differences, including the proposal:

- **(i) to mandate the classification of income and expenses by nature on the face of the operating statement, with the classification aligned with the GFSM 2001 classification scheme to the extent appropriate;**
- **(ii) to mandate a comprehensive income approach whereby all non-owner movements in equity are recognised in a single operating statement; and**
- **(iii) that the option in AASB 119 Employee Benefits (December 2004) of partially deferring actuarial gains and losses on defined benefit superannuation plans using a "corridor approach" should be prohibited, and that the remaining options of recognising them in operating result or in the other non-owner movements in equity section of the operating statement should be allowed. The Board is particularly interested in comments on whether the Standard should remove options entirely, and in so doing, prohibit recognition directly in other non-owner movements in equity;**

(i) The proposal to mandate the classification of income and expenses by nature on the face of the operating statement is consistent with the requirements of AASB 101. Accordingly, ACAG members support the proposal, with the classification aligned with the GFSM 2001 classification scheme to the extent appropriate.

(ii) We note that the proposal for a single statement of comprehensive income is not a sector-neutral proposal as this form of statement is not a requirement of Australian standards going forward (while acknowledging that the IASB and the FASB are currently undertaking a project on financial performance reporting, which includes the consideration of requiring a single statement of comprehensive income). The proposal is nevertheless supported in the interests of convergence with GFSM2001.

(iii) We support the proposal to prohibit the option of accounting for actuarial gains and losses on defined benefit superannuation plans using the "corridor approach" as the concept is not in line with GFS.

We support retention of the other options under AASB 119.

(h) the proposals in paragraphs 41 to 43 relating to the format and content of the cash flow statement. The Board is particularly interested in comments on whether the Standard should also require a distinction between cash flows relating to investing in financial assets for "policy" and "liquidity management" purposes on the face of the cash flow statement and whether such a distinction would be useful and could be made with sufficient rigour for GPFR purposes;

The proposals in paragraphs 41 to 43 are supported.

There would appear to be little difficulty distinguishing "policy" and "liquidity" purposes of investing in financial assets, given the explanation in GFSM paragraph 4.45. However, the purpose of the distinction is to enable 'overall fiscal balance' to be determined. Paragraph 17 of ED 142 requires that this additional GFS-related measure to be reported as long as the disclosure is made in a way that does not detract from the information provided in the Standard. But the measure is the mandatory 'net lending/borrowing' adjusted by transactions in assets and liabilities that are deemed to be for public policy purposes, eg treating subsidies in the form of loans as an expense (see footnote below). Presumably a subsidy cannot be both a loan and an expense under accounting standards, so it is not clear how publication of overall fiscal balance can meet the test in paragraph 17. Hence, consideration should be given to whether the distinction is appropriate.

(i) the proposals in paragraphs 44 and 45 relating to additional information to be provided in the note containing the summary of significant accounting policies, illustrated in Appendix C. In particular, the Board is interested in comments on whether the proposed disclosures provide sufficient information to minimise the risk that users might perceive the GGS financial report as being a substitute for the whole of government GPFR;

We agree that the proposed disclosures would appear to minimise the risk that users might perceive the GGS report as a substitute for the whole of government report.

However, to avoid the GGS financial report achieving de facto primacy over the whole of government report, two things would need to happen:

- it is important that consistency between the treatments in GGS reporting and Whole of government reporting be given priority through urgent completion of Phase 1, and
- governments need to move towards concurrent financial reporting of both GGS and whole of government.

Having a harmonised standard that deals only with GFS may also result in divergence between GFS reporting for the GGS and GFS reporting for the PNFC and PFC sectors of government under the Uniform Presentation Framework.

(j) the proposals in paragraphs 46 to 48 relating to additional disclosures. The Board is particularly interested in comments on whether the proposal in paragraph 46(d) to require disclosure of explanations of key technical terms used in the financial report is useful;

We support the proposed requirement to disclose the additional information outlined in paragraphs 46 to 48, which will assist users of the financial report to better understand the financial statements. We consider that the requirement to disclose explanations of the key technical terms used in the financial report is useful, particularly in the first few years of introduction of the new presentation.

A suggested additional disclosure for paragraph 46(a) is to require explanation of the financial effect of changes in the list of entities comprising the GGS from one year to the next.

Paragraph 46 (b) requires disclosure of information that corresponds to the information required to be disclosed by AASB127 as if the financial statements were both consolidating all controlled entities and also separate financial statements to the extent they do not consolidate controlled entities. The paragraph requires explanatory guidance, eg to make it clear, for example, that the GGS GPFR will detail all contingent liabilities and guarantees/commitments that exist relating to the non-consolidated controlled entities.

Paragraph 47 identifying key technical terms should include “net debt”.

(k) the proposals in paragraphs 49 to 52 relating to disclosures that provide disaggregated information about GAAP and GFS amounts on a functional basis, whereby functions are determined in accordance with GFSM 2001;

We support the proposals in paragraphs 49 to 52 relating to disclosures that provide disaggregated information about GAAP and GFS amounts on a functional basis, as determined in accordance with GFSM 2001, to the extent that the attribution can be done reliably. We believe that disclosure of disaggregated information on a functional basis will be useful in understanding the resources committed to particular functions of the GGS, the costs of service delivery and the extent of the cost recovered in providing those services.

(l) the proposals in paragraphs 53 to 56 to specify principles for the presentation of performance indicators;

One can readily support the principles proposed for the determination and presentation of performance indicators, both financial and non-financial, being relevance and reliability, and comparability and understandability. Also, the encouragement to report performance indicators is also readily supported.

However, unless there is a generally agreed set of performance indicators for the GGS, especially in respect of non-financial performance, it will be difficult to form a view as to quality of non-financial performance overall or in particular areas of common activity. As such, there exists a risk of selectivity in reporting. Auditors-General would also be faced with assessing how non-financial performance indicators that were unacceptable in some sense would affect the truth and fairness of the GGS accounts.

(m) the proposals in paragraphs 57 to 62 to require disclosure of:

- **(i) the original budget, restated if necessary so that it is presented on a basis that aligns with the basis on which the financial statements and notes have been prepared (in accordance with the Standard); and**
- **(ii) an explanation of major variances between the original GGS budget and actual amounts;**

We support the stated objective of the Financial Reporting Council's strategic direction that outcome statements be directly comparable with the relevant budget statements. While budget numbers may be revised more than once during a financial year, the minimum relevant comparison required should be against the original budget, as proposed. Restatement should be undertaken where necessary to align presentation.

We also note the relevance of the proposal to include explanations of budget variances as mandatory disclosures in the financial statements. Explanations of revisions to original budget numbers would be given as revisions are published during the year. In addition, practical difficulties for both the presentation and auditing of the explanations are envisaged. We suggest that the inclusion of explanations of variations be encouraged but not mandated and that the matter be considered further in the context of the International Public Sector Accounting Standards Board's work on Budget Reporting. However, in the event that the AASB decides to include reporting against budget outcomes in the standard, we believe that it should be a requirement that explanation for variations be audited.

(n) the proposals in paragraphs 63 to 67 relating to transitional requirements. In particular, the Board is interested in assessments of the costs and benefits of the approach proposed, compared with alternative approaches, including remaining silent in the Standard about transitional requirements, and thereby effectively requiring AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to operate in its own right;

The proposal for transition is that the first financial report under this Standard be prepared in the same manner as if it is the GGS' first Australian-equivalent-to-IFRSs financial report under AASB 1, subject to the requirement in paragraph 10 of applying non-conflicting requirements of GFSM2001, and in a manner consistent with AASB 1, but without mandating an explanation of variances from current GAAP. For the purposes of this standard, AIFRS are those Australian Accounting Standards incorporated by cross-reference into this Standard as amended by this Standard.

The proposal would therefore require comparative information on the same basis as the current year information, with the given exemptions to full retrospectivity.

The proposal is supported because it builds on the work already done in transitioning to AIFRS and is therefore preferred over an option of being silent and thus effectively mandating AASB 108.

As the first year of mandatory reporting is proposed to be 2006-07, we agree that there should not be a requirement to reconcile to previous GAAP.
Some concern has been expressed that the mandatory timeline for transition may be too tight for preparers and for auditors, given the requirement for comparatives and given that entities are also dealing with reporting under A-IFRS for the first time as at 30 June 2006. An extended transitional period for adopting the proposed standard should be considered, while retaining the option in paragraph 4 of the ED to allow for the early adoption of the standard, where appropriate.

(o) the illustrated acceptable format for the financial statements and notes related to convergence differences in Appendix B. The Board is particularly interested in comments on:

- **(i) the columnar approach illustrated for the balance sheet and operating statement. In addition to any criticisms of the columnar approach, respondents are invited to provide an alternative that is consistent with the Exposure Draft's proposals for the Board's consideration; and**

- **(ii) whether the illustration provides guidance that is helpful in implementing the proposals in the Exposure Draft, particularly those that adopt the requirements in AASB 101 as effectively amended by the proposals;**

Appendix B is useful in that the columnar approach illustrated reflects the nature of the standard as not having fully achieved convergence, and therefore also provides guidance indirectly to note disclosure where the columnar approach is not adopted.

We do not favour the columnar presentation proposed in the guidance due to the presentation difficulties it has. A down the page approach is more practical and could usefully also be illustrated, picking up perhaps on some of the other mandatory information proposed by the standard that is not readily accommodated by the columnar approach eg budget information and comparatives.

Please refer also to our comments under (f) in relation to the liquidity versus current/non-current presentation of the balance sheet.

(p) whether it is appropriate for the Standard to cross-reference to GFSM 2001, given that GFSM 2001 is not prepared by the AASB and that there is a need for the AASB to consider whether amendments to the Standard are necessary each time GFSM 2001 is amended. The Board is also interested in comments on whether instead of GFSM 2001 the Standard should cross-reference to the GFS Manual published by the Australian Bureau of Statistics (ABS);

We agree that the standard should cross-reference to a GFS Manual.

The AASB's decision as to whether to cross-reference to the IMF or ABS versions of GFS should be determined by the needs of the users of the GFS information. The AASB would presumably need to take advice from ABS as to whether ABS would move to reporting locally under IMF GFS once the GGS standard was made, or whether, indeed, ABS is likely to move to the IMF version in any case.

Another concern is that the ABS may be seen as not independent of the Australian Government. Under legislation, the Statistician has security of tenure for the period of appointment and cannot be removed from Office other than in exceptional circumstances. The independence of the ABS is also demonstrated by its different view to the Government on the treatment of the Goods and Services Tax, which for ABS GFS purposes is a Commonwealth and not a State tax.

We would expect that the AASB would have to review the GGS standard for changes to the GFS requirements in respect of those areas where the standard mandates disclosures of particular GFS items, which are contained in black letter, or where consequential changes to detailed guidance are required.

(q) whether there are any aspects of GFSM 2001 that you consider should be prohibited from forming part of the basis upon which the GGS's financial report is prepared; and

No items in GFSM2001 have come to attention which should be prohibited from forming part of the basis upon which the GGS financial report is prepared, other than perhaps the references to fiscal balance discussed in our answer to (h) above.

(r) whether, overall, the proposals result in financial reports that are useful to users.

We accept that there are users for the financial reports of the general government sector and believe that these reports should be general purpose financial reports. ACAG members are disappointed that full convergence has not been possible at this time but regard the work done to date as useful, given that it provides audited GAAP, GFS and reconciliations between the two.

Other comment.

It would appear that the AASB has not provided a comprehensive analysis of all differences between GFS and GAAP. It is appropriate for the AASB to do this, given that it proposes to incorporate by reference the GFSM 2001 manual.